

Message Text

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PAGE 01 MANAGU 02083 302322Z

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ACTION ARA-10

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TAGS: EGIN, EINV

SUBJECT: GON REQUESTS VISIT OF U.S. TAX EXPERT TO DISCUSS
TAXATION ON FOREIGN BANKS IN NICARAGUA

1. VICE MINISTER OF FINANCE RUBEN GARCIA HAS FORMALY ASKED THAT
A USG TAX EXPERT VISIT NICARAGUA TO EXCHANGE VIEWS WITH GON
OFFICIALS ON TAXATION OF INTEREST RECEIVED BY FOREIGN BANKS HERE.
AN EXPERT FROM U.S. PRIVATE BANKING SECTOR TO PARTICIPATE IN THE
DISCUSSIONS IS ALSO WELCOME.

2. A GON MEMORANDUM ACCOMPANYING THE REQUEST STATES:
AS YOU MAY ALREADY KNOW, THE TAX SYSTEM OF NICARAGUA HAS RECENTLY
BEEN REFORMED BY ACT OF CONGRESS ENACTED NOVEMBER 23, 1974. THE
REFORM INCLUDES SUBSTANTIAL MODIFICATIONS TO THE INCOME TAX SYSTEM,
WHICH WILL ENTER INTO EFFECT JANUARY 1ST, 1975. SOME OF THE
PROVISIONS AFFECT THE TAX LIABILITY OF INTEREST INCOME RECEIVED
BY FOREIGN BANKS. ARTICLE 14 OF THE INCOME TAX LAW READS AS
FOLLOWS:

QUOTE

WHEN, IN ACCORDANCE WITH PARTS I), J) AND K) OF THE PREVIOUS
SECTION, THE BANK OR FOREIGN INSTITUTIONS ARE EXEMPTED FROM
TAXES ON THE INTEREST EARNED, THE FOLLOWING RULES WILL APPLY:
A) THE EXEMPTION WILL APPLY IF THE HOME COUNTRY OF SAID BANK
DOES NOT TAX SUCH INTEREST WITH INCOME TAX OR IF IT TAXES THE
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PAGE 02 MANAGU 02083 302322Z

INTEREST WITHOUT GRANTING CREDIT FOR TAXES PAID TO NICARAGUA; AND

B) IF THE BANK'S HOME COUNTRY TAXES SUCH INTEREST BUT CREDITS THE BANK FOR TAXES PAID TO NICARAGUA, THE EXEMPTION SHALL BE CONSIDERED SUSPENDED AS LONG AS THIS SITUATION PREVAILS, AND CONSEQUENTLY THE INTEREST EARNED SHALL BE AFFECTED BY THIS TAX. THE RULES CONTAINED IN THE ABOVE PARTS A) AND B) SHALL BE APPLIED IN GENERAL TO ALL INCOME ORIGINATING IN NICARAGUA EARNED BY INDIVIDUALS OR PRIVATE CONCERN RESIDENT IN FOREIGN COUNTRIES, WHICH RE EXEMPT UNDER THIS LAW OR UNDER ANY LAW OF A GENERAL NATURE. END QUOTE

THE OBJECTIVE OF THE ABOVE-MENTIONED PROVISIONS IS TO ELIMINATE A TAX SACRIFICE IN A SITUATION WHERE TAX EXEMPTION DOES NOT INVOLVE A REAL BENEFIT TO THE LENDER BANK IN SUCH A SITUATION ACCORDING TO THE PROVISION THE TAX HOLIDAY GRANTED TO THE BANK BY NICARAGUA IS NOT APPLICABLE AS LONG AS THE SITUATION PREVAILS. IT SHOULD BE NOTED THAT THE TAX EXEMPTION IS NOT ABROGATED, ONLY ITS EFFECTS ARE SUSPENDED, AND, THEREFORE, IT BECOMES APPLICABLE AS SOON AS THE SITUATION CHANGES. THE SITUATION IS TYPICAL OF A BANK WHOSE COUNTRY OF RESIDENCE TAXES WORLDWIDE INCOME AND AVOIDS DOUBLE TAXATION BY PERMITTING TO CREDIT FOREIGN INCOME TAXES AGAINST DOMESTIC TAX.

IF SITUATIONS WHERE THE COUNTRY OF RESIDENCE OF THE FOREIGN BANK DOES NOT TAX INCOME FROM ABROAD OR IT APPLIES A WORLDWIDE APPROACH WITHOUT RELIEF FOR DOUBLE TAXATION, THEN, THE EXEMPTION IS FULLY APPLICABLE, THE REASONING BEING THAT IN THE FIRST SITUATION THE LENDER BANK DOES NOT BENEFIT FROM THE TAX EXEMPTION SINCE IT WINDS UP PAYING THE SAME AMOUNT OF TOTAL TAXATION WHETHER IT PAYS TAX OR NOT TO NICARAGUA. IT BECOMES OBVIOUS THEN THAT THE NICARAGUAN GOVERNMENT SHOULD TAX INTEREST INCOME DERIVED FROM NICARAGUAN SOURCES. THE AMOUNT PAID TO NICARAGUA IS INDIFFERENT TO THE BANK AS LONG AS IT DOES NOT EXCEED THE COUNTRY OF RESIDENCE TAX. OTHERWISE, THAT IS, SHOULD THE NICARAGUAN GOVERNMENT EXEMPT FROM TAX INEREST INCOME IT WOULD ONLY INCREASE TAX PAYABLE TO THE RESIDENCE COUNTRY OF THE BANK, THUS NULLIFYING THE TAX EXEMPTION SO GRANTED.

ONE INTERESTING FEATURE OF THE SCHEME SHOULD BE NOTED. AS ALREADY MENTIONED, EXEMPTIONS GRANTED BY LAW IN CONDITIONS THEREIN LIMITED OFFICIAL USE

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PAGE 03 MANAGU 02083 302322Z

ESTABLISHED CONTINUE TO BE LEGALLY VALID, ONLY ITS EFFECTS ARE SUSPENDED BUT ONLY FOR AS LONG AS THE TAX STATUE OF THE FOREIGN COUNTRY TAXES INTERESTS ORIGINTING IN NICARAGUA AND ALLOWS A CREDIT, FOR TAX PAID TO NICARAGUA.

IT SHOULD BECOME APPARENT THAT IN A SITUATION WHERE THE COUNTRY OF RESIDENCE OF THE FOREIGN BANK DOES NOT TAX WORLDWIDE INCOME AT ALL OR IF IT TAXES SUCH INCOME WITHOUT AVOIDING DOUBLE TAXATION

THE EXEMPTION GRANTED BY NICARAGUA BENEFITS THE FOREIGN BANK
IN FULL.

THEREFORE IN THOSE SITUATIONS THE EXEMPTION REMAINS APPLICABLE.
AS IT CAN BE SEEN, THE NEW LAW IN THIS RESPECT HAS MADE AN
ACCOMMODATION OF THE TAX HOLIDAY TO INTERNATIONAL TAXATION, WITH
NO IMPAIRMENT TO THE FAVORABLE AX TREATMENT THAT NICRAGUA HAS
TRADITIONALLY OFFERED FOREIGN BANKS DOING FINANCIAL OPERATIONS IN
NICARAGUA.

3. GARCIA MENTIONED THE NAME OF STANLEY SURREY, WHO WORKED FOR
MANY YEARS FOR DEPARTMENT OF TREASURY AS KNOWLEDGEABLE IN THIS FIELD.

4. EMBASSY WOULD APPRECIATE A POSITIVE RESPONSE TO THIS REQUEST.
WE BELIEVE EXPERT MIGHT ALSO USE OPPORTUNITY TO DISCUSS PROS AND
CONS OF A DOUBLE TAXATION AGREEMENT WITH U.S. MINISTRY OF
FINANCE OFFICIAL HAS EXPRESSED HIS OPINION THAT STANDARD TREATY
DISCRIMINATES IN FAVOR OF U.S.
SHELTON

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